

Report  
of the  
Examination of  
MGIC Residential Reinsurance Corporation  
Milwaukee, Wisconsin  
As of December 31, 2002

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# State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

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**Jorge Gomez, Commissioner**

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August 22, 2003

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Honorable Jorge Gomez  
Commissioner of Insurance  
State of Wisconsin  
125 South Webster Street  
Madison, Wisconsin 53702

Commissioners:

In accordance with the instructions of the Wisconsin Commissioner of Insurance (the "Commissioner"), a compliance examination has been made of the affairs and financial condition of:

MGIC RESIDENTIAL REINSURANCE CORPORATION  
Milwaukee, Wisconsin

and this report is respectfully submitted.

Honorable Susan F. Cogswell  
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## **I. INTRODUCTION**

The previous examination of MGIC Residential Reinsurance Corporation ("MRRC," or the "company") was conducted in 1998 and 1999 as of December 31, 1997. The current examination covered the intervening period ending December 31, 2002, and included a review of such 2003 transactions as deemed necessary to complete the examination.

The examination consisted of a review of all major phases of the company's operations, and included the following areas:

- History
- Management and Control
- Corporate Records
- Conflict of Interest
- Fidelity Bonds and Other Insurance
- Employees' Welfare and Pension Plans
- Territory and Plan of Operations
- Affiliated Companies
- Growth of Company
- Reinsurance
- Financial Statements
- Accounts and Records
- Data Processing

Emphasis was placed on the audit of those areas of the company's operations accorded a high priority by the examiner-in-charge when planning the examination. Special attention was given to the action taken by the company to satisfy the recommendations and comments made in the previous examination report.

The section of this report titled "Summary of Examination Results" contains comments and elaboration on those areas where adverse findings were noted or where unusual situations existed. Comment on the remaining areas of the company's operations is contained in the examination work papers.

The company is annually audited by an independent public accounting firm as prescribed by s. Ins 50.05, Wis. Adm. Code. An integral part of this compliance examination was the review of the independent accountant's work papers. Based on the results of the review of these work papers, alternative or additional examination steps deemed necessary for the completion of this examination were performed. The examination work papers contain

documentation with respect to the alternative or additional examination steps performed during the course of the examination.

## **II. HISTORY AND PLAN OF OPERATION**

MGIC Residential Reinsurance Corporation was organized under the laws of Wisconsin on July 1, 1996, and commenced business activity on that date. The company is a wholly owned subsidiary of MGIC Investment Corporation ("MGIC Investment").

MRRC was organized to provide the affiliated insurer Mortgage Guaranty Insurance Corporation ("MGIC") with excess of loss reinsurance coverage on primary and pool residential mortgage guaranty insurance risks. MRRC's business consists of reinsurance of risks written on a direct basis by MGIC in 6 states that do not permit a direct writing insurer to recognize balance sheet credit for reinsurance ceded to a subsidiary insurer. MRRC assumes from MGIC one-third of the liability for mortgage guaranty net losses in excess of 25% of the indebtedness to the insured, subject to the limit of a maximum assumption of 25% of the indebtedness. The company derives all of its written business from its assumption of risks written by MGIC, and does not cede any insurance risks.

MRRC does not have any employees, and all of its business operations are performed by MGIC pursuant to an intercompany services agreement. Further discussion of the MGIC Investment Corporation holding company, description of MRRC's significant affiliates, and description of the company's intercompany agreements are included in the section of this report captioned "Affiliated Companies."

The company is licensed in the states of California, Illinois, Kansas, Maryland, New York, Texas, and Wisconsin.

In 2002, the company assumed \$3,231,055 of mortgage guaranty insurance premiums. The growth of the company is discussed in the Financial Data section of this report.

### III. MANAGEMENT AND CONTROL

#### Board of Directors

The MGIC Residential Reinsurance Corporation board of directors consists of seven members, each of whom is elected annually from within the senior executive management of MGIC Investment Corporation. MRRC directors are elected to serve a one-year term. Each member of the MMRC board of directors also serves as a member of other boards of directors in the holding company group, and receives no additional compensation for services performed as a director of MMRC.

Currently, the MMRC board of directors consists of the following persons:

<b>Name and Residence</b>	<b>Principal Occupation</b>	<b>Term Expires</b>
Curt S. Culver Nashotah, WI	President and Chief Executive Officer MGIC Investment Corporation	2004
John D. Fisk Kensington, MD	Executive Vice President – Strategic Planning MGIC Investment Corporation	2004
Joseph J. Komanecki Delafield, WI	Senior Vice President, Controller and Chief Accounting Officer	2004
Jeffrey H. Lane Glendale, WI	Senior Vice President, General Counsel and Secretary MGIC Investment Corporation	2004
J. Michael Lauer Elm Grove, WI	Executive Vice President and Chief Financial Officer MGIC Investment Corporation	2004
Patrick Sinks River Hills, WI	Senior Vice President – Field Operations MGIC Investment Corporation	2004
Joseph J. Ziino, Jr. Brookfield, WI	Senior Vice President – Regulatory Relations, Associate General Counsel and Assistant Secretary MGIC Investment Corporation	2004

## **Officers of the Company**

MGIC Residential Reinsurance Corporation officers are appointed by the company's board of directors at the annual meeting of the board, and serve a one-year term of office. Senior officers serving at the time of this examination are listed below. Each MRRC officer is employed by MGIC, and a portion of the MGIC compensation costs for the respective MRRC officers is allocated to MRRC through an affiliated servicing agreement. The annual compensation paid to MRRC officers in 2002 is reported in the concurrent examination report of MGIC, under the caption "Officers of the Company."

<b>Name</b>	<b>Office</b>
Curt S. Culver	President and Chief Operating Officer
J. Michael Lauer	Executive Vice President and Chief Financial Officer
Joseph J. Komanecki	Senior Vice President, Controller and Chief Accounting Officer
Jeffrey H. Lane	Senior Vice President, General Counsel and Secretary
Joseph J. Ziino, Jr.	Senior Vice President – Regulatory Relations Associate General Counsel and Assistant Secretary
James A. Karpowicz	Vice President and Treasurer

## **Committees of the Board**

The MRRC bylaws allow for the formation of certain committees by the board of directors. The company had established one committee of the board at the time of the examination, listed below:

**Securities Investment Committee**  
J. Michael Lauer  
Joseph J. Komanecki  
Joseph J. Ziino, Jr.



#### **IV. AFFILIATED COMPANIES**

MGIC Residential Reinsurance Corporation is a member of a holding company system. The ultimate parent of the holding company system is MGIC Investment Corporation.

The following organizational chart depicts the relationships among the affiliates in the holding company group. Each respective subsidiary is a wholly owned affiliate within the MGIC enterprise except as noted otherwise. A brief description of the significant affiliates of MGIC Residential Reinsurance Corporation and a summary of significant affiliated agreements follows the organizational chart.

##### **Organizational Chart As of December 31, 2002**

- MGIC Investment Corporation
  - Mortgage Guaranty Insurance Corporation
    - MGIC Reinsurance Corporation of Wisconsin
      - MGIC Mortgage Insurance Corporation
        - MGIC Mortgage and Consumer Asset II LLC (Note #1)
    - MGIC Credit Assurance Corporation
    - MGIC Assurance Corporation
      - MGIC Assurance Corporation Segregated Account
    - MGIC Reinsurance Corporation of Vermont
    - GHR Systems, Inc. (12% ownership interest)
    - MGIC Indemnity Corporation
    - eMagic.com
    - Sherman Financial Group LLC (45.5% ownership interest)
    - Equix Financial Services LLC (70.5% ownership interest)
    - MGIC Mortgage and Consumer Asset I LLC (Note #1)
      - CMI Investors LP 5 (99% ownership interest)
      - CMI Investors LP 8 (99% ownership interest)
      - CMI Investors LP 9 (99% ownership interest)
      - CMI Investors LP 2 (99% ownership interest)
      - Credit-Based Asset Servicing & Securitization LLC (45.9% ownership interest)
      - Litton Loan Servicing LP
  - MGIC Reinsurance Corporation
  - MGIC Mortgage Reinsurance Corporation
  - MGIC Residential Reinsurance Corporation
  - MGIC Mortgage Marketing Corporation
  - MGIC Investor Services Corporation
  - MGIC Insurance Services Corporation
  - MGIC Mortgage Securities Corporation
  - MGIC OneStop Holdings LLC
    - OneStop Shop, Inc. (24% ownership interest)

Note # 1: MGIC Mortgage and Consumer Asset II LLC holds a 1% ownership interest in CMI Investors LP's; the remaining 99% interest is held in MGIC Mortgage and Consumer Asset I LLC.

**MGIC Investment Corporation (“MGIC Investment”)**

MGIC Investment was incorporated in Wisconsin on June 22, 1984 under the name Management Financing Corporation. MGIC Investment was established as a holding company to consolidate the ownership and capitalization of the legal entities within the MGIC enterprise. The initial capital funding of Management Financing Corporation was provided by The Northwestern Mutual Life Insurance Company and by senior executive officers of MGIC. The holding company name was changed to MGIC Investment Corporation effective March 1, 1985. An initial public offering of MGIC Investment common capital stock was completed in August of 1991, and a second public offering was completed in June 1992. The issued and outstanding shares of MGIC Investment common capital stock are traded on the New York Stock Exchange.

As of February 15, 2003, Legg Mason, Inc., an investment management company, held a 14.59% ownership interest in the outstanding MGIC Investment Corporation capital stock, and Janus Capital Management LLC held a 12.16% ownership interest in MGIC Investment. Officers and directors of MGIC Investment Corporation, who comprise 17 individual share holders, in aggregate held 1.26% ownership interest in MGIC Investment. Interests held by officers and directors included 31,085 share units held under MGIC Investment Corporation's directors' deferred compensation plan for which the holders currently do not have rights to exercise investment or voting power. Other investors, each of whom individually owned less than a 5% interest in MGIC Investment, held the remaining outstanding shares of MGIC Investment common capital stock.

The MGIC enterprise is principally engaged in writing mortgage guaranty insurance on residential mortgage loans. MGIC Investment Corporation insurance subsidiaries provide mortgage guaranty insurance to mortgage lenders, and its non-insurance operating subsidiaries provide products and services to the mortgage finance industry, including contract underwriting, mortgage portfolio analysis, secondary market mortgage brokerage and trading services, and internet-based technology services.

As of December 31, 2002, MGIC Investment's consolidated GAAP basis audited financial statements reported total assets of \$5,300,303,000, total liabilities of \$1,905,111,000,

and total shareholders' equity of \$3,395,192,000. Operations for 2002 provided reported net income of \$629,191,000.

**Mortgage Guaranty Insurance Corporation ("MGIC")**

MGIC was incorporated under the laws of Wisconsin on February 20, 1979 as Liberty Mortgage Insurance Corporation ("LMIC"). LMIC was originally owned by Verex Corporation and was acquired by MGIC Investment Corporation in November 1984. The name Liberty Mortgage Insurance Corporation was changed to Mortgage Guaranty Insurance Corporation on March 1, 1985, when MGIC began writing new business.

MGIC formerly had two classes of issued and outstanding common capital stock, Class A common stock and Class B common stock. MGIC Investment Corporation retained ownership of the MGIC Class B common stock, and effective September 30, 1985 contributed 100% of the MGIC Class A common stock to the former MGIC Investment subsidiary Mortgage Guaranty Reinsurance Corporation ("MGRC"). Effective May 25, 1999, MGRC was dissolved pursuant to a plan of voluntary dissolution and liquidation approved by the Commissioner. Upon the dissolution of MGRC, all 35,000 issued and outstanding shares of MGIC Class B common stock held by MGIC Investment were redeemed at a price of \$1,000 per share, and the remaining assets and liabilities of the liquidated MGRC legal entity including 100% of the MGIC Class A common capital stock transferred to MGIC Investment Corporation. MGIC's capital stock presently is comprised solely of one class of common stock, wholly owned by MGIC Investment Corporation.

MGIC issues residential mortgage guaranty insurance in 50 states, the District of Columbia, Puerto Rico, and Bermuda. MGIC serves as the lead operating company in the MGIC group, and provides administrative and managerial services to its affiliates. MGIC's direct and indirect costs incurred in providing services to its affiliates are allocated to the respective affiliates pursuant to intercompany services agreements. Excess of loss insurance coverages on risks written by MGIC are ceded to four MGIC affiliate insurers to enable MGIC to comply with statutory restrictions in some states that limit an insurer's net retention of mortgage guaranty insurance for any one risk to not more than 25% of the total indebtedness to the insured.

As of December 31, 2002, MGIC's statutory financial statements reported total admitted assets of \$5,748,861,544, total liabilities of \$4,200,854,153, and policyholders' surplus of \$1,548,007,391. Operations for 2002 provided reported net income of \$256,475,739.

**MGIC Reinsurance Corporation of Wisconsin ("MRCW")**

MRCW was incorporated under the laws of Wisconsin on February 15, 1996, and commenced operations on April 1, 1996. MRCW was established to provide reinsurance to MGIC for primary and pool mortgage guaranty policy liabilities in excess of 25% of the total indebtedness to the insured, for mortgage guaranty policies written in all jurisdictions except six states. MRCW assumes all of its business from MGIC, and does not cede any business.

As of December 31, 2002, MRCW's statutory financial statements reported total admitted assets of \$648,397,711, total liabilities of \$200,721,132, and policyholder's surplus of \$447,676,579. Operations for 2002 provided reported net income of \$27,646,621.

**MGIC Mortgage Insurance Corporation ("MMIC")**

MMIC was incorporated under the laws of Wisconsin on April 30, 1987. MMIC was established to be an insurer that maintains a Standard and Poor's Corporation AAA claims paying ability rating, to provide the MGIC group with the facility to write mortgage guaranty insurance on loans that require the insurer to be rated AAA. MMIC assumes coverages issued by MGIC, and does not write any direct insurance business. MMIC has not assumed any new risks from MGIC for the past several years.

Prior to 1996, MMIC was a wholly owned subsidiary of MGIC. In 1996 MGIC contributed 100% of the common capital stock of MMIC to MGIC Reinsurance Corporation of Wisconsin.

As of December 31, 2002, MMIC's statutory financial statements reported total admitted assets of \$79,579,265, total liabilities of \$11,512,325, and policyholder's surplus of \$68,066,940. Operations for 2002 provided reported net income of \$4,535,872.

**MGIC Credit Assurance Corporation ("MCAC")**

MCAC was organized under the laws of Wisconsin on April 30, 1997, and commenced business on May 21, 1997. MCAC is a wholly owned subsidiary of MGIC, and was

established to write mortgage guaranty insurance for lenders in certain states on second mortgages and home equity lines of credit. MCAC commenced writing direct business in 1998, and terminated writing new business effective January 1, 2002. MCAC's current portfolio of insurance risks consists solely of renewal business on existing policies, and MCAC's entire book of business is in run-off.

As of December 31, 2002, MCAC's statutory financial statements reported total admitted assets of \$36,120,251, total liabilities of \$14,915,547, and policyholder's surplus of \$21,204,704. Operations for 2002 resulted in a reported net loss of \$5,573,957.

#### **MGIC Assurance Corporation ("MAC")**

MAC was organized under the laws of Oklahoma in 1937 under the name Insurers Indemnity and Insurance Company, and was subsequently renamed Financial Security Assurance, Inc. of Oklahoma ("FSAOK"). FSAOK was acquired by MGIC in 1995, and effective November 18, 1996, MAC redomesticated to Wisconsin and adopted the name MGIC Assurance Corporation.

MAC established a segregated account in 1997 pursuant to the requirements of s. 611.24 (1), Wis. Statutes and s. Ins 3.09 (12)(g), Wis. Adm. Code, through which MAC is authorized to conduct junior lien guaranty insurance business. MAC commenced writing insurance on second mortgages and home equity lines of credit in 1997. MAC terminated writing new business effective January 1, 2002. MAC's current portfolio of insurance risks consists solely of renewal business on existing policies written through the segregated account, and MAC's entire book of business is in run-off.

In 1997, all of the issued and outstanding capital stock of MAC was contributed to the MGIC subsidiary insurer MGIC Surety Corporation ("Surety"). MGIC Surety Corporation was merged with and into MGIC effective November 30, 2002. Upon the merger of Surety, the assets and liabilities of MGIC Surety Corporation, including 100% of the issued and outstanding capital stock of MAC, transferred to MGIC.

As of December 31, 2002, MAC's statutory financial statements reported total admitted assets of \$35,284,592, total liabilities of \$12,516,380, and policyholder's surplus of \$22,768,212. Operations for 2002 produced net income of \$232,734.

**MGIC Reinsurance Corporation of Vermont ("MRCV")**

MRCV was established in December 1999 as a Vermont-domiciled insurer, to operate as a sponsored captive insurance company pursuant to Title 8, Chapter 141 of the State of Vermont Statutes. The Vermont Statutes permit a licensed insurer and participating sponsors to establish a sponsored captive reinsurance company to reinsure business written by the licensed insurer. MRCV reinsures MGIC mortgage guaranty risks on loans that were originated, purchased, or serviced by mortgage lenders which participate in MRCV captive reinsurance. For the business assumed by MRCV on behalf of a participating sponsor, MRCV establishes a protected cell account in which assets of each such participant are separately maintained and accounted for with respect to the participant's liabilities for mortgage guaranty risks assumed by the participant. A separate participation agreement is established between MRCV and each respective participant. By establishing a participation agreement with MRCV, a lender which desires to engage in captive reinsurance is able to participate as a sponsored captive and is not required to establish a separate insurance or reinsurance legal entity. As of year-end 2002, MRCV had nine participation agreements in effect.

As of December 31, 2002, MRCV's statutory financial statements reported total admitted assets of \$3,971,536, including \$1.3 million of trust assets, total liabilities of \$1,073,387, and policyholder's surplus of \$2,898,149. Operations for 2002 produced net income of \$776,615.

**MGIC Indemnity Corporation ("MIC")**

MGIC Indemnity Corporation is a Wisconsin-domiciled mortgage guaranty insurer originally incorporated in Wisconsin in 1956 under the name Mortgage Guaranty Insurance Corporation ("Old MGIC"). Old MGIC was a subsidiary of the former MGIC Investment Corporation ("Old MGIC Investment," the pre-1985 MGIC Investment Corporation). Ownership of Old MGIC Investment and its subsidiaries including Old MGIC was purchased by Baldwin-United Corporation ("Baldwin") in 1982. Baldwin became financially impaired in 1983 due in part to

excess corporate debt, and filed petition for voluntary reorganization under Chapter 11 of the Federal Bankruptcy Code.

In 1984 the Commissioner approved a plan (the “Plan”) whereby the ongoing successful business enterprise of Old MGIC could be protected from the bankruptcy of Baldwin and be continued in a successor legal entity. Pursuant to the Plan, effective February 28, 1985 the business operations of Old MGIC were transferred to a successor insurer named Mortgage Guaranty Insurance Corporation (the present-day MGIC), Old MGIC changed its name to Wisconsin Mortgage Assurance Corporation (“WMAC”), and WMAC entered into court-ordered liquidation proceedings under the supervision of the Commissioner.

Under the 1985 liquidation proceedings, WMAC discontinued issuance of new insurance business, its existing book of business entered run-off status managed by the present day MGIC, and 100% of WMAC’s existing net retained liability for insurance risks was ceded to a group of international reinsurers under quota share reinsurance treaties. In December 1998, the WMAC liquidation proceedings were terminated and WMAC entered rehabilitation proceedings. Mortgage Guaranty Insurance Corporation (the present-day MGIC) purchased WMAC as of December 31, 1998 under a plan of rehabilitation approved by the Commissioner. WMAC changed its name to MGIC Indemnity Corporation effective June 1, 2000. MIC has not written any new business since 1985, and its entire portfolio of business is comprised of renewal policies in run-off. All claims have been paid by WMAC or its reinsurers, and only a small amount of insurance inforce remains in run-off.

As of December 31, 2002, MIC’s statutory financial statements reported total admitted assets of \$20,154,586, total liabilities of \$273,834, and policyholder’s surplus of \$19,880,752. Operations for 2002 provided reported net income of \$646,092.

#### **eMagic.com, LLC (“eMagic”)**

eMagic.com, LLC was organized in February 2000 to provide business-to-business interactive electronic services to the mortgage finance industry. eMagic products and services provide an internet technological facility to lenders, mortgage service providers, and other

mortgage institutions, to access wholesaler/investor products and vendor services that pertain to the origination of mortgage loans.

As of December 31, 2002, eMagic.com, LLC's GAAP basis financial statements reported total admitted assets of \$1,753,000, total liabilities of \$1,148,000, and members' equity of \$604,000. Operations for 2002 resulted in a reported net loss of \$10,577,000.

#### **Credit-Based Asset Servicing & Securitization LLC ("C-BASS")**

C-BASS is a joint venture in which MGIC had a 45.9% ownership interest as of year-end 2002. The venture was formed in July 1996 to engage in the acquisition and resolution of delinquent or otherwise credit sensitive single family mortgage loans. C-BASS purchases, sells, and securitizes residential mortgage loans, seller-financed notes, mortgage-backed securities, and other asset-backed debt securities.

As of December 31, 2002, C-BASS's GAAP basis audited financial statements reported total assets of \$1,754,392,000, total liabilities of \$1,384,855,000, and owners' equity of \$369,537,000. Operations for 2002 provided reported net income of \$138,335,000.

#### **MGIC Reinsurance Corporation ("MGIC Re")**

MGIC Re was incorporated under the laws of Wisconsin on February 21, 1985, and commenced business on March 1, 1985. MGIC Re was organized to provide MGIC with excess of loss reinsurance coverage. MGIC Re provides reinsurance to MGIC on primary and pool mortgage guaranty coverage in excess of 25% of the total indebtedness to the insured, on business written in six states. MGIC Re assumes all of its business from MGIC.

As of December 31, 2002, MGIC Re's statutory financial statements reported total admitted assets of \$167,387,887, total liabilities of \$108,714,843, and policyholder's surplus of \$58,673,044. Operations for 2002 provided reported net income of \$5,983,955.

#### **MGIC Mortgage Reinsurance Corporation ("MMRC")**

MMRC was organized under the laws of Wisconsin on July 1, 1996, and commenced business activity on that date. MMRC was organized to provide MGIC with excess of loss reinsurance coverage. MMRC provides reinsurance to MGIC on mortgage guaranty primary and pool coverage in excess of 25% of the total indebtedness to the insured on business written in six



states. MMRC's reinsurance on any loan is limited to a maximum of 25% of the total indebtedness to the insured. MMRC assumes all of its business from MGIC, and does not cede any business.

As of December 31, 2002, MMRC's statutory financial statements reported total admitted assets of \$16,101,360, total liabilities of \$2,088,409, and policyholder's surplus of \$14,012,951. Operations for 2002 provided reported net income of \$1,159,246.

### **Affiliated Agreements**

1. 1986 Tax Sharing Agreement – The MGIC enterprise maintains a Tax Sharing Agreement whereby MGIC Investment Corporation and specified subsidiaries that qualify under the Internal Revenue Code join in filing a consolidated federal income tax return. Tax benefit or liability attributed to each respective legal entity under the consolidated income tax return is based on the amount of benefit or liability that would otherwise be applicable if the respective legal entity filed a separate United States Corporation Income Tax Return. For purposes of income tax sharing, each subsidiary computes its own income on a separate company basis, and each computes its own respective taxes by applying on a separate company basis the provisions of the Internal Revenue Code. The Tax Sharing Agreement is amended from time-to-time as necessary to add or delete the participation of applicable affiliated entities, and currently provides that each of the Wisconsin-domiciled MGIC insurers is a participant in the agreement.
2. 1996 Servicing Agreement – MGIC maintains a Servicing Agreement under which MGIC performs management and administrative services for the benefit of various affiliates within the MGIC holding company. Services provided by MGIC to its affiliates include provision of office space and employees; administration of underwriting, risk management and claims; performance as agent for funds collection and disbursement; maintenance of investment portfolios and execution of investment transactions; maintenance of depository accounts; maintenance of books and records including financial records; and the preparation and delivery of reports, tax returns, and documents and filings as required. MGIC's direct costs and indirect expenses incurred in providing services to the individual affiliates are allocated to the respective affiliates. The Servicing Agreement is amended from time-to-time as necessary to add or delete the participation of applicable affiliated entities, and currently provides that each of the Wisconsin-domiciled MGIC insurers is a participant in the agreement.

## **V. REINSURANCE**

The reinsurance portfolio and strategy of MGIC Residential Reinsurance Corporation is described below. The company's reinsurance contracts contain proper insolvency provisions.

All of MRRC's business is derived from reinsurance of residential mortgage guaranty insurance risks that are written on a direct basis by MGIC. The reinsurance assumed from MGIC by MRRC facilitates MGIC's compliance with the statutory requirements that limit a mortgage guaranty insurer's retention under a single policy of insurance to no more than 25% of debt of the mortgage borrower.

The company has two reinsurance assumption agreements with MGIC, whereby the company assumes one-third of the liability for net losses in excess of 25% of the indebtedness to the insured, subject to the limit of a maximum assumption of 25% of the indebtedness. The company assumes business written in six states (California, Illinois, Kansas, Maryland, New York, and Texas) that do not permit an insurer to recognize balance sheet credit for reinsurance ceded to a subsidiary insurer. The company does not cede any insurance risk and is not party to ceding reinsurance contracts.

## **VI. FINANCIAL DATA**

The following financial statements reflect the financial condition of the company as reported in the December 31, 2002, annual statement to the Commissioner of Insurance. Also included in this section are schedules that reflect the growth of the company, NAIC Insurance Regulatory Information System ("IRIS") ratio results for the period under examination, and the minimum policyholder position calculation. Adjustments made as a result of the examination are noted at the end of this section in the area captioned "Reconciliation of Surplus per Examination."

**MGIC Residential Reinsurance Corporation**  
**Assets**  
**As of December 31, 2002**

	<b>Assets</b>	<b>Nonadmitted Assets</b>	<b>Net Admitted Assets</b>
Bonds	\$14,260,181	\$ 0	\$14,260,181
Cash	962,986		962,986
Agents' balances or uncollected premiums:			
Premiums and agents' balances in course of collection	438,447		438,447
Federal and foreign income tax recoverable and interest thereon	9,476		9,476
Interest, dividends, and real estate income due and accrued	<u>254,244</u>	<u>          </u>	<u>254,244</u>
Total Assets	<u>\$15,925,334</u>	<u>\$ 0</u>	<u>\$15,925,334</u>

**MGIC Residential Reinsurance Corporation**  
**Liabilities, Surplus, and Other Funds**  
**As of December 31, 2002**

Losses		\$ 1,971,059
Reinsurance payable on paid loss and loss adjustment expenses		3,885
Loss adjustment expenses		11,564
Federal and foreign income taxes		7,850
Unearned premiums		71,101
Payable to parent, subsidiaries, and affiliates		<u>4,729</u>
Total Liabilities		2,070,188
Common capital stock	\$2,000,000	
Gross paid in and contributed surplus	8,000,000	
Unassigned funds (surplus)	<u>3,855,146</u>	
Surplus as Regards Policyholders		<u>13,855,146</u>
Total Liabilities and Surplus		<u>\$15,925,334</u>

**MGIC Residential Reinsurance Corporation**  
**Summary of Operations**  
**For the Year 2002**

**Underwriting Income**

Premiums earned		\$3,161,729
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Deductions:

Losses incurred	\$ 83,267	
Loss expenses incurred	5,059	
Other underwriting expenses incurred	849,953	

Write-ins for underwriting deductions:

Statutory contingency reserve contributions less withdrawals	<u>1,580,865</u>	
Total underwriting deductions		<u>2,519,144</u>

Net underwriting gain		642,585
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**Investment Income**

Net investment income earned	722,729	
Net realized capital gains	<u>60,673</u>	
Net investment gain		<u>783,402</u>

Net income before federal and foreign income taxes		1,425,987
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Federal and foreign income taxes incurred		<u>340,000</u>
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Net Income		<u>\$1,085,987</u>
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**MGIC Residential Reinsurance Corporation**  
**Cash Flow**  
**For the Year 2002**

Premiums collected net of reinsurance	\$ 2,804,767
Deduct:	
Loss and loss adjustment expenses paid (net of salvage or subrogation)	3,901
Underwriting expenses paid	<u>849,953</u>
Cash from underwriting	1,950,913
Net investment income	758,602
Deduct:	
Federal income taxes paid	<u>376,913</u>
Net cash from operations	\$ 2,332,602
Proceeds from investments sold, matured, or repaid:	
Bonds	\$3,007,535
Cost of investments acquired (long-term only):	
Bonds	<u>5,184,701</u>
Net cash from investments	(2,177,166)
Cash applied for financing and miscellaneous uses:	
Net transfers to affiliates	<u>6,926</u>
Net change in cash and short-term investments	148,510
<b>Reconciliation</b>	
Cash and short-term investments, December 31, 2001	<u>814,476</u>
Cash and short-term investments, December 31, 2002	<u>\$ 962,986</u>

**MGIC Residential Reinsurance Corporation**  
**Policyholder Position Calculation**  
**December 31, 2002**

Surplus as regards policyholders			\$13,855,146
Contingency reserve			<u>1,702,111</u>
Total policyholders' position			15,557,257
Net minimum policyholders' position			
Individual loans:			
Loan-to-value more than 75%		\$ 350,936	
Group of Loans:			
Equity 20 - 50%, or equity plus prior insurance or deductible 25 – 55%	\$1,771,412		
Equity more than 50%, or equity plus prior insurance or a deductible less than 25%	<u>32,314</u>		
Total group loans		<u>1,803,727</u>	
Minimum policyholder position			<u>2,154,662</u>
Excess of total policyholders' position over minimum policyholders' position			<u>\$13,402,595</u>



**MGIC Residential Reinsurance Corporation**  
**Reconciliation and Analysis of Surplus**  
**For the Five-Year Period Ending December 31, 2002**

The following schedule is a reconciliation of total surplus during the period under examination as reported by the company in its filed annual statements:

	<b>1998</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>
Surplus, beginning of year	\$10,718,020	\$11,178,191	\$11,659,902	\$12,268,321	\$12,766,159
Net income	460,171	481,711	608,419	508,688	1,085,987
Change in net deferred income tax					3,000
Cumulative effect of changes in accounting principles				(10,850)	
Surplus, end of year	<u>\$11,178,191</u>	<u>\$11,659,902</u>	<u>\$12,268,321</u>	<u>\$12,766,159</u>	<u>\$13,855,146</u>

**MGIC Residential Reinsurance Corporation**  
**Insurance Regulatory Information System**  
**For the Five-Year Period Ending December 31, 2002**

The company's NAIC Insurance Regulatory Information System ("IRIS") results for the years under examination are summarized in the following table. The unusual IRIS results during the period are denoted with asterisks, and are discussed following the table of IRIS data.

	<b>Ratio</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>
#1	Gross Premium to Surplus	0%	0%	0%	0%	23%
#2	Net Premium to Surplus	0%	0%	0%	0%	23%
#3	Change in Net Writings	(71)%*	1,299%*	(64)%*	158%*	7,396*
#4	Surplus Aid to Surplus	0%	0%	0%	0%	0%
#5	Two-Year Overall Operating Ratio	0%	(2,213)%	(1,995)%	(2,048)%	38%
#6	Investment Yield	6%	65	6%	6%	5%
#7	Change in Surplus	4%	4%	5%	4%	9%
#8	Liabilities to Liquid Assets	1%	2%	2%	3%	13%
#9	Agents' Balances to Surplus	0%	0%	0%	0%	3%
#10	One-Year Reserve Devel. to Surplus	0%	(1)%	(2)%	(1)%	(1)%
#11	Two-Year Reserve Devel. to Surplus	0%	(1)%	(1)%	(2)%	(1)%
#12	Estimated Current Reserve Def. To Surplus	0%	(1)%	(2)%	(2)%	0%

IRIS ratio number 3 evaluates the year-to-year change in an insurer's net written premium. The company's unusual results for IRIS ratio number 3 in 1998, 1999, 2000, and 2001 reflect changes in the volume of MGIC direct writings of deep coverages (coverages of more than 25% of the indebtedness to the insured) and corresponding changes in the volume of reinsurance cessions to MRRC of such coverages. The company's unusual result in 2002 was due to increased MGIC cessions under prior reinsurance treaties, and to cessions under a new primary reinsurance treaty established between MGIC and MRRC in 2002 that applies to business written by MGIC for a new mortgage guaranty product.

## Growth of MGIC Residential Reinsurance Corporation

Year	Admitted Assets	Liabilities	Surplus As Regards Policyholders	Net Income
1998	\$11,313,311	\$ 135,120	\$11,178,191	\$ 460,171
1999	11,896,842	236,940	11,659,902	481,711
2000	12,479,986	211,665	12,268,321	608,419
2001	13,139,094	372,935	12,766,159	508,688
2002	15,925,334	2,070,188	13,855,146	1,085,987

  

Year	Gross Premium Written	Net Premium Written	Premium Earned	Loss And LAE Ratio	Expense Ratio	Combined Ratio
1998	\$ 3,278	\$ 3,278	\$ 3,278	1,993%	997.8%	2,990.8%
1999	45,863	45,863	44,068	231.1%	93.3%	324.4%
2000	16,686	16,686	16,426	(256.3)%	419.3%	163.0%
2001	43,101	43,101	43,381	40.9%	363.1%	404.0%
2002	3,231,055	3,231,055	3,161,729	2.8%	75.2%	78.0%

Annual net contingency reserve contributions, required due to annual changes in premiums written, are included in the expense ratio calculations reported above, and contributed to the high expense ratios experienced by the company in each of the years under examination.

MRRC commenced assumption of mortgage guaranty insurance risks in 1996, and its written premium volume remained low through 2001. The company had underwriting losses in 1998, 1999, 2000, and 2001, and the large combined ratios in those years reflect the start-up of the company and large incurred losses and underwriting expenses relative to small premium revenue volume during those years. Underwriting losses were offset by investment income in each of the four-years of underwriting loss, resulting in favorable net income in each year. The company's increased premium volume in 2002 was due to increased MGIC direct written premium production of deep coverages that required MRRC reinsurance of excess risks. The company's increased premium volume in 2002 was sufficient to cover losses and expenses and enabled the company to realize underwriting profit.

**Reconciliation of Surplus per Examination**

The examination did not make any reclassification of or adjustment to year-end balances reported by the company. The company's surplus as regards policyholders as of December 31, 2002 was \$13,855,146.

## **VII. SUMMARY OF EXAMINATION RESULTS**

### **Compliance with Prior Examination Report Recommendations**

There was one specific comment and recommendation in the previous examination report. Comment and recommendation contained in the previous examination report and actions taken by the company are as follows:

1. Management and Control—It is recommended that the company's board of directors review executive decisions made on behalf of the company by the parent corporation, and that the board exercise its responsibility to manage the company by taking action on those decisions, by resolution of the company's board of directors

Action — Compliance

### **Summary of Current Examination Results**

The current examination did not result in any findings of material exception, and did not result in any recommendations requiring company action or compliance.

## **VIII. CONCLUSION**

MGIC Residential Reinsurance Corporation was organized under the laws of Wisconsin on July 1, 1996. The company is a wholly owned subsidiary of MGIC Investment Corporation, and is licensed in seven states.

The company assumes from MGIC one-third of the liability for residential mortgage guaranty primary and pool insurance net losses in excess of 25% of the indebtedness to the insured. Risks assumed by the company are on insurance policies written in six states. All of the company's business is derived from assumption of mortgage guaranty insurance risks written on a direct basis by MGIC. The company does not cede any of its business.

The examination determined that the company is in compliance with the single recommendation that resulted from the previous examination of the company. The current examination did not result in any findings of material exception, and did not result in any reclassification of account balances or adjustment to surplus. As of December 31, 2002, the company reported net admitted assets of \$15,925,334, total liabilities of \$2,070,188, and total surplus as regards policyholders of \$13,855,146.

## **IX. SUMMARY OF COMMENTS AND RECOMMENDATIONS**

The current examination did not result in any findings of material exception, and did not result in any recommendations requiring company action or compliance.

## **X. ACKNOWLEDGMENT**

The courtesy and cooperation extended during the course of the examination by the officers and employees of the company are acknowledged.

In addition to the undersigned, the following representatives of the Office of the Commissioner of Insurance, State of Wisconsin, participated in the examination:

<b>Name</b>	<b>Title</b>
Rebecca Easland	Insurance Financial Examiner
Ryan Hanson	Insurance Financial Examiner
Tom M. Janke	Insurance Financial Examiner
Russell Lamb	Insurance Financial Examiner
Randy Milquet	Insurance Financial Examiner—Advanced

Respectfully submitted,

Thomas E. Rust  
Examiner-in-Charge